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ANALYSIS OF WAYS AND MEANS TO IMPROVE MARKET OPPORTUNITIES FOR COMMODITIES IN THE MEDIUM TERM, WITH EMPHASIS ON EXAMINATION OF THE BEST WAYS OF ACHIEVING DIVERSIFICATION, TAKING INTO ACCOUNT COMPETITIVENESS, MARKET TRENDS AND OPPORTUNITIES

Improving market opportunities for commodities in the medium term, with emphasis on achieving diversification

Report by the UNCTAD secretariat

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CONTENTS

Chapter		Paragraphs
I.	MARKET TRENDS FOR COMMODITIES AND THE EVOLUTION OF EXPORT DIVERSIFICATION IN DEVELOPING COUNTRIES	1 - 11
II.	NATIONAL POLICIES: COMPETITIVENESS, MARKET OPPORTUNITIES AND DIVERSIFICATION	12 - 42
	A. National policies designed to provide economic incentives	13 - 20
	B. National policies designed to improve the capability of market participants to respond to economic incentives	21 - 28
	C. Ways and means for a country to find market opportunities for its commodities	29 - 42
III.	INTERNATIONAL POLICIES AFFECTING MARKET OPPORTUNITIES FOR COMMODITIES AND OPPORTUNITIES FOR DIVERSIFICATION . .	43 - 60
	A. Ways and means of increasing the market opportunities for commodities in the medium term	43 - 50
	1. Market access	43
	2. Improving information on demand and market requirements	44 - 45
	3. Generic promotion of commodities	46 - 48
	4. Promotion of new end-uses of commodities . . .	49 - 50
	B. Support for diversification	51 - 58
	C. Conclusions	59 - 60

Chapter I

MARKET TRENDS FOR COMMODITIES AND THE EVOLUTION OF EXPORT DIVERSIFICATION IN DEVELOPING COUNTRIES

1. The evolution of commodity prices as well as of supply and demand for commodities over the last few years has recently been discussed in several documents[1] and will therefore not be addressed in detail here. The main conclusions of these documents include (i) that real commodity prices declined by about 50 per cent between 1980 and the beginning of the 1990s; (ii) that the price fall in agricultural commodities accounted for the bulk of the drop in the aggregate price index; (iii) that beverages constituted the commodity group experiencing the sharpest drop in prices;[2] (iv) that tropical timber was the only individual commodity for which price increases could be observed; (v) that the major cause for the general price fall lay in substantial increases in the supply of commodities, even though sluggish demand in industrial countries may also have contributed; (vi) that the major part of the supply increase came from the developed world, rather than from the developing or highly indebted countries; and (vii) that the increase in aggregate commodity prices over the last few months suggests that the downward trend in commodity prices may have bottomed out, at least temporarily.

2. The impact of a decline in the price of commodity exports on the real value of a country's earnings from those exports depends on the development of the volume of commodity exports. Evidence given by figure 2 suggests that the volume of non-oil commodity exports from developed countries as well as from developing countries in Asia has risen, to the extent that these countries achieved a substantial increase in the real value of their non-oil commodity export earnings despite the drop in prices. Countries of Developing America have by and large maintained the real value of their non-oil commodity exports despite the sharp drop experienced in the mid-1980s, while the commodity price decline of the last 20 years has led to a substantial decrease in the real value of non-oil commodity exports from African countries as a group, since the volume of such exports from these countries has declined as well, as suggested by figure 3.[3] Figures 4 to 6 suggest that the export volume of agricultural raw materials and of minerals and metals[4] from African countries has dropped, while the volume of food exports from these countries has registered a slight increase over the last 20 years. However, the increased volume of food exports has not translated into a substantial increase in their real value because food was the commodity group

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[1] See, for example, UNCTAD, "The commodity situation, developmental linkages between the commodity sector and other sectors, and actions required to develop such linkages in the context of diversification" (1994), forthcoming as a General Assembly document and World Bank, *Global economic prospects and the developing countries* (Washington, D.C., 1994).

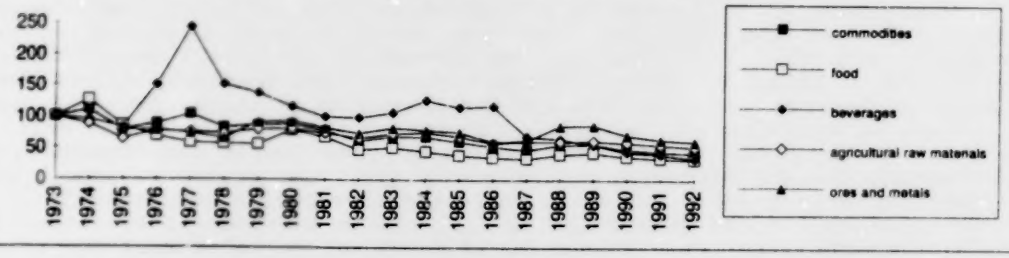
[2] See figure 1 for evidence on these conclusions.

[3] It should be noted that evidence from figures 3 to 6 can give only a rough idea of the trends in the volume of commodity exports as volume indices have been calculated using the same four price indices (for non-oil primary commodities as a group, for food, for agricultural raw materials, and for minerals and metals) for all groups of countries. More disaggregated data are not available to date.

[4] It would appear that the enormous percentage increase in the export volumes of minerals and metals that countries from West Asia have achieved over the last ten years has not had a major impact on the markets, as the market shares of these countries are very small. On the other hand, this development illustrates the success these countries have had in using their large energy resources as secondary inputs for the energy-intensive processing of imported metal ores, for example, for the production of aluminum.

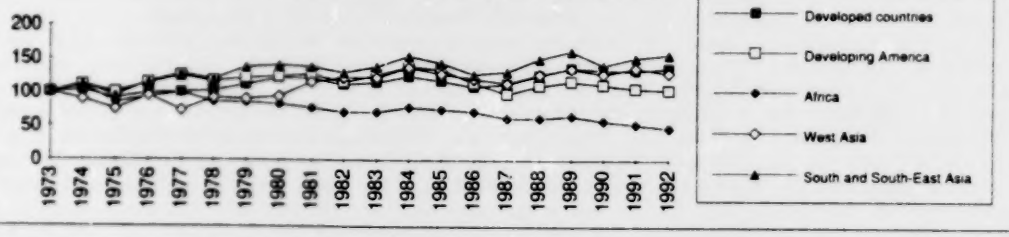
that experienced the sharpest decline in prices over the same period (see figure 1).[5]

Figure 1: Real market-price indices of selected primary commodity groups, 1973=100 (deflated by export unit values of manufactured goods from developed countries)



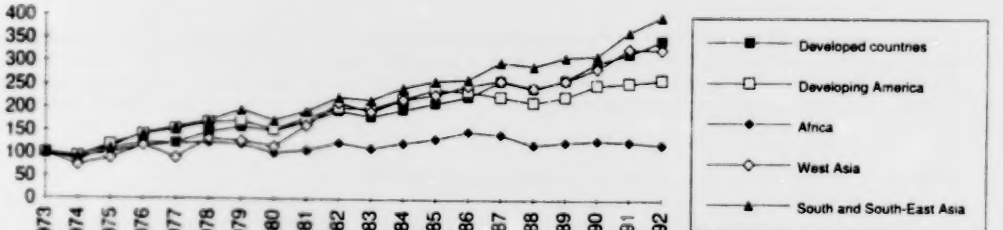
Source: UNCTAD database.

Figure 2: Real value of non-oil primary commodity exports by region, index numbers: 1973=100 (deflated by export unit values of manufactured goods from developed countries)



Source: Nominal values from UNCTAD Commodity Yearbook, price indices from UNCTAD Commodity Price Bulletin.

Figure 3: Volume of non-oil primary commodity exports by region, index numbers: 1973=100



Source: Nominal values from UNCTAD Commodity Yearbook, price indices from UNCTAD Commodity Price Bulletin.

[5] Note that countries which have a large market share in the export of a specific commodity may be faced with an "adding-up" problem, meaning that an increase in the volume of these exports would cause a drop in prices. Some African countries, in particular those exporting cocoa, may be among this group of countries.

Export volume indices by region and commodity groupings

Figure 4: Food

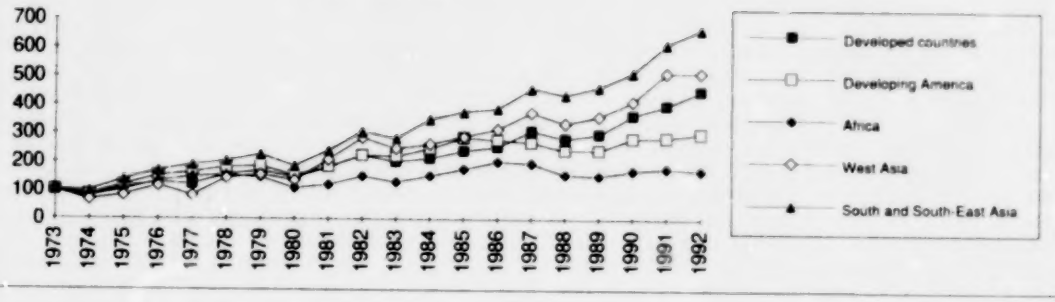


Figure 5: Agricultural raw materials

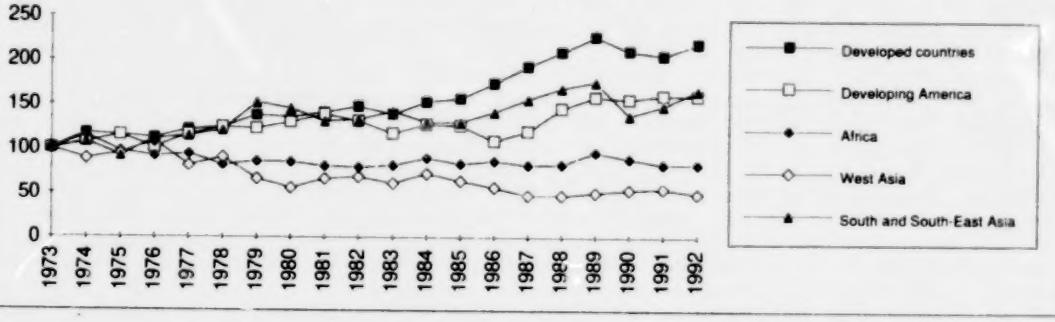
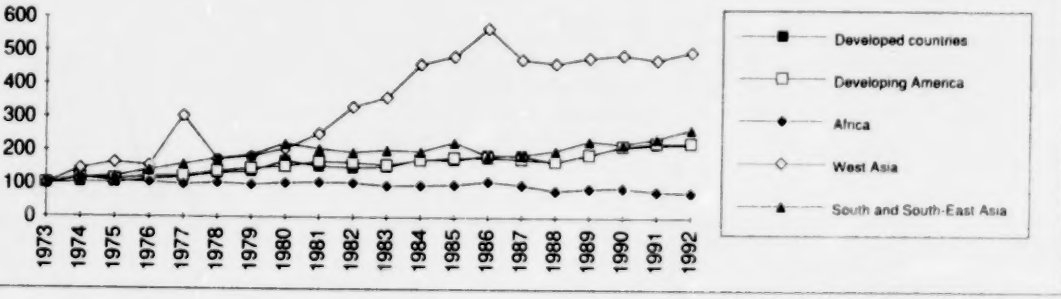


Figure 6: Minerals and metals



Source: Nominal values from *UNCTAD Commodity Yearbook*, price indices from *UNCTAD Commodity Price Bulletin*.

3. Several developing countries have successfully diversified their export structure both out of commodities and within the commodity sector since the end of the 1970s.[6] The extent of this reduction of dependence on the commodity sector and, in particular, on a small number of commodities in their export earnings has, however, varied considerably. Developing countries in South and South-East Asia as well as, to a lesser extent, those in Latin America and North Africa were relatively successful in this respect, while little improvement, or in some cases even a deterioration, has taken place in many sub-Saharan African and the South Pacific countries. The experience of successfully diversifying countries[7] indicates that there is no unique recipe to be followed by all countries. Rather, it appears that successful diversification is the outcome of the interplay of several interrelated factors including external and domestic policy conditions. Certain basic factors such as natural resource endowment, geophysical and climatic characteristics and the size of the domestic markets, while setting a limit to the development of diversification activities, do not seem to be decisive barriers. By contrast, establishing a conducive economic environment in the domestic economy to enhance competitiveness and backing this up by appropriate legislative and other supportive measures, in particular those encouraging private-sector initiatives, seems to be common to all successful diversification experiences.

4. Table 1.1 provides statistical evidence on the interrelationship between export dependence and selected economic indicators. Data on dependence are presented as three-year averages for the periods 1979-1981 and 1989-1991; data for the selected economic indicators are presented as five-year averages for the periods 1977-1981 and 1987-1991, except for school enrolment figures for which different periods have been selected to take account of the time lag between the acquisition of knowledge at school and its use. Given that many developing countries started economic reform in the first half of the 1980s, the first period can be considered a pre-adjustment period and the second period one of adjustment or post-adjustment. The group of 59 countries selected for this analysis consists of 25 developing countries from Africa, 15 countries from Developing America, and 19 developing countries from Asia; 16 least developed countries are among these countries. The selected group is divided into five subgroups according to the countries' diversification experience varying from very successful diversification to significantly increased dependence. Within these subgroups, the countries are ordered according to GDP growth in the second period in an effort to examine whether diversification follows from growth and whether countries that have grown vigorously have substantially reduced export dependence.[8]

5. Columns (2) and (3) of the table show that 25 of the selected developing countries achieved a significant reduction in their export dependence, whereas the situation worsened for 13 countries and no significant change occurred in 21 countries. It is noteworthy that 8 out of the 11 countries which had a dependence of 40 or less per cent in the first period were successful in further reducing their dependence, sometimes significantly, or in maintaining their low level of dependence, and that India and Zimbabwe are the only countries in this group which experienced a significant increase in dependence. By contrast, in

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[6] See table 1.1. Diversification within and out of the commodity sector reduces a country's vulnerability to sector-specific adverse changes on world commodity markets. As a reduction of this vulnerability can be considered the basic objective of diversification, a country's dependence on a limited number of commodity sectors appears to be a more meaningful measure of diversification than dependence on the commodity sector as a whole.

[7] For evidence, see UNCTAD: *Analysis of national experiences in horizontal and vertical diversification, including the possibilities for crop substitution*, TD/B/CN.1/14, 14 September 1993.

[8] World Bank: *Global economic prospects and the developing countries*, Washington, D.C. (1994) p. 34.

Table 1.1: The interrelationship between a country's export dependence on its three main commodities and selected economic indicators

Country or territory	Dependence on three main commodities 1)		General economic indicators						Economic indicators related to saving and investment						Economic indicators related to the availability of foreign exchange			
			GDP growth rate		per capita GDP		Secondary school enroiment		National savings rate		Investment-GDP ratio		Foreign direct investment (mn US$)		Debt service/foreign exchange earnings ratio		Terms-of-trade index 1970=100	
	1979-81	1989-91	1977-81	1987-91	1977-81	1987-91	1974-78	1982-86	1977-81	1987-91	1977-81	1987-91	1977-81	1987-91	1977-81	1987-91	1977-81	1987-91
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)	(19)
Dependence reduced by 10 or more percentage points																		
Singapore	33	20	9.0	8.9	5060	8897	54	67	34	44	42	38	775	3041	2	1	n.a.	n.a.
Malaysia	52	30	7.6	8.4	1674	2279	46	52	29	29	29	28	736	1843	6	13	148	114
Hong Kong	29	14	10.8	6.6	4700	8269	52	70	30	34	33	29	n.a.	n.a.	2	2	n.a.	n.a.
Indonesia	75	50	8.1	6.5	434	586	21	40	29	31	23	34	211	844	13	34	323	249
Ghana	85	65	1.1	4.8	591	523	36	39	6	9	7	12	12	12	7	43	128	59
Syrian Ar.Rep.	89	57	6.3	4.5	1583	1487	44	57	15	6	28	16	n.a.	n.a.	16	24	111	74
Tunisia	80	56	6.1	4.3	1021	1170	22	36	23	19	30	22	151	85	16	28	455	305
Philippines	38	25	5.2	3.8	654	599	58	66	27	19	29	20	77	576	19	29	64	64
Colombia	68	56	4.9	3.8	1138	1319	41	45	20	22	19	19	98	383	14	41	128	85
Bolivia	68	55	1.5	3.6	990	737	31	36	14	3	19	12	33	15	32	52	220	143
Mexico	66	40	7.4	2.9	2382	2311	37	53	19	18	26	21	1441	2474	56	33	163	125
Egypt	86	69	8.7	2.8	850	1145	45	62	20	4	30	29	579	850	28	43	112	81
Madagascar	73	55	0.1	1.0	345	267	14	35	0	1	12	13	n.a.	n.a.	11	47	101	73
Argentina	46	35	1.2	0.6	2533	2145	56	65	22	10	21	9	483	1286	27	42	75	56
Cote d'Ivoire	71	53	4.0	-1.4	793	597	14	19	12	0	27	11	60	54	22	62	126	83
Cameroon	71	46	13.0	-6.2	654	734	15	23	10	13	24	28	75	-12	11	21	114	80
Dependence reduced by between 9 and 5 percentage points																		
Thailand	37	30	7.3	10.6	589	999	27	30	20	27	27	32	136	1428	13	17	99	80
Korea Rep.	33	25	6.4	9.5	1619	3265	61	88	25	36	32	34	41	249	13	16	89	89
Uganda	98	91	-3.4	6.0	251	251	4	9	0	3	5	11	n.a.	n.a.	8	64	87	85
Kenya	64	57	6.8	4.9	317	335	15	20	17	16	27	24	50	36	13	37	128	86
Jamaica	82	73	-1.4	4.3	998	973	58	59	12	16	17	27	-9	73	18	38	106	96
Bangladesh	85	78	5.0	3.9	137	164	22	18	4	6	13	12	n.a.	2	13	34	70	60
Venezuela	94	88	1.6	3.9	4359	3691	40	46	33	22	33	19	78	389	17	25	336	235
Morocco	60	51	2.6	3.8	551	624	18	32	15	21	27	23	58	159	34	40	122	132
Fiji	69	64	4.9	2.3	1778	1762	61	53	20	14	29	16	20	32	4	12	n.a.	n.a.
No significant change in commodity dependence																		
Cyprus	36	35	8.5	6.4	2726	4459	95	95	21	25	36	27	66	75	8	22	69	55
Nigeria	94	97	0.0	5.9	1241	1010	10	29	24	12	25	10	152	832	6	27	428	297
Turkey	39	41	2.0	4.7	971	1209	32	40	17	22	18	23	50	521	23	37	n.a.	n.a.

Table 1.1: The interrelationship between a country's export dependence on its three main commodities and selected economic indicators

Paraguay	76	74	10.7	4.4	1197	1262	22	30	21	19	28	24	31	37	13	19	87	78
Burundi	87	90	5.1	4.1	224	252	3	4	4	1	14	16	n.a.	1	5	43	n.a.	n.a.
Guinea	95	93	1.3	4.0	366	271	14	13	n.a.	8	n.a.	19	n.a.	n.a.	25	22	n.a.	n.a.
Solomon Isl.	79	82	n.a.	3.9	n.a.	n.a.	n.a.	n.a.	10	8	n.a.	32	3	10	4	12	n.a.	n.a.
Guatemala	48	50	4.4	3.5	1675	1395	13	18	15	8	19	13	116	139	7	32	89	64
Gambia	77	74	3.0	3.5	284	306	11	17	-1	4	25	18	n.a.	n.a.	4	21	89	60
Ecuador	78	82	5.4	2.6	1723	1663	42	55	20	13	26	21	55	80	22	35	363	293
Uruguay	46	42	4.1	2.6	1936	2018	61	70	18	14	16	13	150	n.a.	23	40	88	82
Senegal	66	66	-0.6	2.6	408	411	10	13	-1	4	17	12	11	n.a.	13	33	127	115
Papua N. Guin.	68	71	1.8	2.0	736	694	12	11	10	5	22	25	48	143	6	32	n.a.	n.a.
Zambia	94	93	0.4	1.1	402	305	16	17	9	2	21	12	23	114	22	18	42	42
Brazil	36	33	4.3	0.7	1711	1799	29	35	18	22	23	22	1930	964	56	28	120	103
Niger	95	91	6.9	0.7	293	206	3	5	11	0	30	14	30	n.a.	12	39	69	59
Algeria	99	98	5.2	0.2	2376	2360	24	46	38	25	44	31	126	-8	28	57	425	304
Cent.Afr.Rep	75	74	-0.7	-0.1	289	244	9	15	-4	-6	10	12	8	-3	3	15	120	102
Zaire	76	73	-0.1	-1.5	252	212	18	34	4	8	20	11	n.a.	n.a.	12	34	58	49
Jordan	40	40	10.6	-1.6	1224	1326	67	79	40	7	36	23	55	18	16	32	105	87
Peru	41	45	3.3	-2.7	1002	829	49	62	19	17	23	20	60	30	34	17	70	56
Dependence increased by between 5 and 9 percentage points																		
Botswana	88	94	11.5	9.6	696	1353	18	26	12	20	35	27	76	55	11	4	n.a.	n.a.
Tanzania U.Rep	49	56	1.5	4.0	353	323	4	3	14	1	25	37	n.a.	n.a.	12	37	111	74
Gabon	90	96	-6.3	0.8	4597	3020	17	17	44	23	38	30	38	19	21	12	478	404
Dependence increased by 10 or more percentage points																		
Chile	57	68	7.9	6.6	1082	737	49	64	12	16	19	19	204	273	42	28	44	40
Pakistan	58	71	6.5	5.8	243	328	15	17	14	20	18	19	55	191	23	35	77	59
India	25	39	4.6	5.5	237	322	27	37	22	21	22	25	n.a.	n.a.	12	27	73	70
Nepal	52	69	3.2	5.4	138	157	14	24	14	11	17	21	n.a.	n.a.	3	15	n.a.	n.a.
Honduras	62	74	5.6	3.6	875	804	18	33	14	11	25	21	11	45	13	38	92	77
Sri Lanka	63	73	5.7	3.5	376	399	48	61	15	15	24	23	28	41	9	25	114	79
Burkina Faso	67	88	3.5	3.2	167	192	2	4	0	5	20	22	2	n.a.	7	15	87	85
Zimbabwe	31	50	3.4	3.0	532	563	9	36	13	18	16	21	1	-9	2	17	n.a.	n.a.
Dominican Rep	56	72	4.4	1.5	712	717	37	55	19	15	24	25	65	117	18	16	79	71
Benin	69	80	5.7	1.2	231	242	10	19	2	5	21	14	3	n.a.	9	10	65	58

Note: 1) Commodities considered for calculating dependence are primary commodities including fuels (SITC sections 0-4 (less groups 233, 244, 266, 267), division 68 and item 522.56) plus precious stones and non-monetary gold, as well as semi-processed and processed forms of leather; rubber articles; veneer sheets, plywood and other wood articles; paper and paperboard; silk yarn and fabrics; cotton yarn, fabrics and clothing; jute products; and steel.

Data sources: Columns (2) and (3) UNCTAD database. Columns (4) to (7) and columns (16) to (19) from UNCTAD Handbook of International Trade and Development Statistics, tables 6.1, 6.2, 5.14, and 7.2. Columns (8) and (9) from World Bank. Columns (10) to (15) from International Financial Statistics, except for investment data for Bangladesh, Burkina Faso, Central African Republic, Gambia, Guinea, Hong Kong, and Madagascar which are from World Bank.

Table 1.2: Correlation coefficients

Dependence	GDP growth 1977-1981	GDP growth 1987-1991	per capita GDP 1977-1981	per capita GDP 1987-1991	Secondary school enrolment 1977-1981	Secondary school enrolment 1987-1991
1979-1981	-0.29	-0.18	-0.17	-0.34	-0.43	-0.46
1989-1991	-0.38	-0.17	-0.28	-0.45	-0.54	-0.57
Dependence	**National savings rate** 1977-1981	**National savings rate** 1987-1991	**Investment** 1977-1981	**Investment** 1987-1991	**Foreign direct investment** 1977-1981	**Foreign direct investment** 1987-1991
1979-1981	-0.28	-0.46	-0.11	-0.31	-0.24	-0.32
1989-1991	-0.41	-0.51	-0.17	-0.29	-0.39	-0.51
Dependence	**Debt service/foreign exchange earnings ratio** 1977-1981	**Debt service/foreign exchange earnings ratio** 1987-1991	**Terms of trade index** 1977-1981	**Terms of trade index** 1987-1991		
1979-1981	-0.04	0.28	0.44	0.40		
1989-1991	-0.12	0.13	0.33	0.33		

Note: A negative sign of the correlation coefficient means, for example, that those countries which had a higher growth rate than others also had a lower level of dependence than other countries.

the group of 8 countries which had a dependence of 90 or more per cent in the first period, only two (Uganda and Venezuela) experienced a significant reduction in dependence; however, these countries are still highly dependent. This suggests the presence of a self-perpetuating momentum in dependence and diversification, with the result that a well-diversified economy is often a springboard for further diversification and that excessive dependence tends to prolong dependence.

6. Table 1.2 presents the correlation coefficients regarding dependence and the selected economic indicators. Given that such coefficients can not indicate directions of causality, and ignore the interplay among variables, any conclusions drawn have to be based on plausibility and treated as tentative only. A general observation, however, is that developing countries with high growth rates (columns (4) and (5)) have been more successful in reducing dependence than others. The notable exceptions from this pattern are Botswana and Chile. Whereas no strong causal relationship can be established on the basis of this parallel evolution of high GDP growth and reduced export dependence, the correlation coefficients suggest the presence of a slight positive influence of high GDP growth in the first period on reduced dependence in the second period.

7. It would appear, however, that this evidence does not imply that growth alone is a springboard for diversification. Cote d'Ivoire and Cameroon, for example, have reduced dependence significantly but experienced severe setbacks in their growth performance. Although these countries suffered a significant adverse movement in their terms of trade (columns (18) and (19)), their external economic environment did not worsen more than that of, for example, Bolivia, Colombia or Ghana, i.e., countries with a much more favourable growth experience.

The latter countries, however, initiated economic reform earlier and with a better resolve, with the result that their economies were more flexible in adjusting to external shocks. It is also interesting to note that several countries (Brazil, Jordan, and Peru) with low dependence in the first period experienced low growth in the second period. These countries faced a sharp drop in foreign direct investment as well as a drop in domestic investment between the first and the second period. Whilst this outcome could indicate that diversification hampers growth, it seems more plausible that these countries' experience highlights the importance of sustained strong investment for continued growth.

8. Chile appears to be an example of a country that has succeeded in exploiting its comparative advantage in the commodity sector and in building buoyant growth on dynamic parts of the sector (in particular on fisheries and fruit). Further examples of countries which obtained strong GDP growth on the basis of the strong export performance of parts of their commodity sector, be they traditional or non-traditional commodities of the respective economies, include Thailand (fisheries), Indonesia (tropical timber), Ghana (tropical timber and bauxite/aluminium), Kenya (horticultural products and tea), Uganda (cotton and cereals), and Colombia (horticultural products and coal). This suggests that both high growth and export diversification are often the result of a strong, sometimes traditional, commodity sector.

9. Regarding other general economic indicators, the tables show that most successfully diversifying countries are middle-income countries (columns (6) and (7)) and that school enrolment figures (columns (8) and (9)) are on average higher in these countries than in others. The former finding points to the importance of an adequate size of the domestic market as a basis for export activities, while the latter highlights the importance of a high general level of education for taking advantage of market opportunities. The data also suggest that higher national savings rates (columns (10) and (11)) and, to a much lesser extent, investment to GDP ratios (columns (12) and (13)) are positively correlated with diversification. In addition, successful diversification appears to be positively correlated with a high level of foreign direct investment (columns (14) and (15)). This could indicate that attracting foreign investors allows for the import of new production and marketing methods conducive to diversification, provided that these methods can be adapted by the domestic economy. It is also noteworthy that foreign direct investment tends to be concentrated in a few countries, mainly middle-income countries in East Asia and Latin America. The correlation coefficients give some evidence suggesting that high foreign direct investment occurred before diversification took place, while increased investment to GDP ratios seem to have materialized parallel with or after diversification. However, the empirical basis for this conclusion is relatively weak, calling for further research in this area.

10. Regarding data on the availability of foreign exchange, there appears to be no correlation between dependence and high debt-service payments in ratio to foreign-exchange earnings from the export of goods and services (columns (16) and (17)). Data on the evolution of the countries' terms-of-trade index (columns (18) and (19)) suggest that, excluding oil exporters, unsuccessful diversifiers have experienced a long-term decline in their terms of trade, evidenced by the fact that the figures are lower than 100 in both periods. By contrast, the index for most successful diversifiers was higher than, or close to, 100 in at least the first period. This suggests that the persistence of favourable market prices of a country's export commodities provides a good stimulus to diversification.

11. Two broad conclusions may be drawn on the basis of this evidence. Firstly, given that those countries that have been most successful in export diversification, i.e., countries from East Asia and Developing America, are among those that have increased the volume of non-oil commodity exports the most, it would appear that a strong commodity sector is a good basis for export diversification. This suggests that diversification within, as well as out of, the commodity sector is an important factor in success. Secondly, problems on

the supply side and a lack of competitiveness in the commodity sector may have been an important reason for the poor economic performance of African countries as a group over the last few years. This may lay the basis for the presumption that reform of national policies designed to improve the competitiveness of the commodity sector is a condition for an improved economic performance of African countries in the future.

Chapter II

NATIONAL POLICIES: COMPETITIVENESS, MARKET OPPORTUNITIES AND DIVERSIFICATION

12. Ways and means for countries to improve their competitiveness and opportunities for diversification are often identified with progress in the organization of and techniques employed in the production process. It has, however, increasingly been recognized that adopting a marketing policy which ensures that identified export markets can be penetrated and maintained is a necessary complement to being competitive in terms of production processes. Non-price factors, such as access to the required information or the development of an export association which is considered a reliable counterpart in international trade, therefore need to be taken into account. This chapter will discuss national policy reform designed to raise a country's competitiveness in the production process before its focus turns to the marketing side of export diversification.

A. National policies designed to provide economic incentives

13. A large number of developing countries have embarked on economic reform since the beginning of the 1980s. Pursuing national policies designed to improve the country's competitiveness* is often considered as the major determinant for a more successful performance; this was the case for the East Asian countries. By contrast, the absence of policies that encourage export diversification or the increase of foreign-exchange reserves in order to smooth the impact of adverse external shocks is likely to magnify the negative impact of the difficult external environment on domestic economic performance and diversification; this appears to have been the case for many developing countries in sub-saharan Africa and the South Pacific. Given that policies designed to raise competitiveness affect all economic agents, be they active in the commodity sector or not, the key aspects of these general policy measures merit a brief discussion.

14. Although there have been substantial differences from country to country in the speed and intensity as well as in the mix and range of policy instruments used in economic reform, countries have tended to apply a common set of macroeconomic measures, trade policy reforms and other liberalization measures. Demand management measures including currency devaluation and fiscal restraint have usually marked the start of economic reform. These measures were then reinforced on the supply side by microeconomic and institutional reforms concentrating on liberalization of the country's external trade regime, its price and marketing systems in domestic agriculture and industry, and its financial sector. A key assumption of this reform strategy has been that "getting the prices right" would trigger a supply response that would eventually lead to a sustainable economic performance.

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* An increase in a country's competitiveness is reflected in its ability to raise its share of export markets, or to sustain a relatively higher rate of growth of domestic demand without a deterioration in its current-account balance (e.g., caused by sourcing higher domestic demand by increased imports or financial inflows).

15. The real exchange rate is a crucial price in any economy as it has a major influence on a country's opportunities for exports and on the returns to domestic producers. Almost all developing countries experienced a depreciation of their real exchange rate during the 1980s with the vast majority starting the process of exchange-rate adjustment in the first half of the decade. Although concurrent devaluations may have been ineffective in improving external competitiveness, they have changed the relative price between the tradable and non-tradable sectors in the domestic economy, thus strengthening domestic agriculture. Taxation of the agriculture sector implied by exchange-rate overvaluation can, in fact, be considered as having been a major obstacle to diversification out of the commodity sector in many developing countries.[10]

16. Improving access to foreign exchange - by replacing government control of the allocation of foreign exchange with market mechanisms - can be as important as removing overvaluation for imparting impetus to a diversification programme (see box 1 for some examples). For when a sizable share of foreign-exchange transactions takes place in parallel markets, the principal effect of liberalizing access to foreign exchange is to steer foreign exchange into official channels, thereby raising official foreign-exchange receipts. In particular, countries which are naturally endowed with easily transportable resources of high value, such as gold or precious stones, can expect a substantial improvement of officially recorded exports from this measure, which in turn, could encourage a shift of government expenditure towards extension services such as geographical mapping or quality control, in favour of these sectors. In addition, it could raise the incentives for private and foreign investors to become active in those sectors. By contrast, when foreign-exchange transactions have been constrained by controls and regulations, the main effect of foreign-exchange liberalization is to strengthen incentives for export production, in particular by improving access to imported production inputs. Timely availability of the latter is often important for the diversification of output and exports.

Box 1

Foreign exchange regime reforms

While foreign-exchange regimes have been relatively free for many years in countries such as Bolivia, Sri Lanka and the members of the CFA-franc zone, other countries, for example, Argentina, Bangladesh, Colombia, Ghana, Guinea, Guyana and Malawi, have recently completed, or nearly completed, unification of exchange markets and allowed full retention of export proceeds. Other countries, such as Uganda, adopted reforms to absorb the parallel market into a system of foreign-exchange bureaux, establishing the exchange rate in auctions. Some of these reforms have affected the commodity sector directly. The Kenyan Government, for example, has required all transactions on the tea auctions in Mombasa to be made in US dollars since August 1992. This has facilitated faster payments to both producers and exporters, as well as the import of production inputs, and has reduced the exposure of exporters to exchange-rate risk.

17. Other measures aimed at "getting the prices right" have been directed at creating a neutral set of incentives for imports and exports at a low and unified

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[10] Experience has shown that many countries which have been successful in diversifying have built their improved performance on a strong agricultural sector. An important element of Colombia's success in fostering economic growth and reducing its dependence on coffee exports was the rise in its exports of fruits and cut flowers, in addition to the country's good fortune in discovering coal and petroleum deposits. Rising exports of tropical timber contributed to the reduction in Indonesia's dependence on petroleum exports and to the strengthening of employment-creating forward and backward linkages in the economy. Other exporters of tropical timber, such as Gabon and Ghana, also experienced a boost to their economy as timber was one of the few primary commodities that has not experienced a large decline in export prices over the last few years.

level of tariffs. A recent analysis[11] of the relationship between such liberalization of the trade and payments system and diversification of output and export over the 1980s for 24 African least-developed countries concluded that countries with low scores on the liberalization index tended to have negative average export growth, low manufacturing growth and no export diversification. However, while this analysis suggests that faster growing and diversifying economies tend to have higher values for the liberalization index, it is difficult to determine how much of this better performance can be imputed to trade liberalization. A favourable shift in the terms of trade or a rescheduling of external debt, for example, would raise the availability of foreign exchange allowing for higher imports and, probably, reduce the premium on foreign exchange. An attempt to separate out the influence of different policy shifts such as trade liberalization therefore requires taking account of the particular circumstances of different countries.

18. Development of the financial sector allowing for a high level of financial intermediation is a crucial determinant of realizing fully the gains from stabilization, liberalization and private sector activity, because bank and non-bank institutions can encourage a more efficient allocation of new investment by favouring entrepreneurial investors and faster growth sectors. A very important commodity-specific issue in financial-sector reform is how to make commodities acceptable as collateral for bank credits. Contrary to commercial banks in developed countries, banks in many developing countries require fixed assets as collateral. This implies that access to official credit is severely constrained for those producers and exporters of commodities whose physical capital, e.g., buildings, is low.[12] Moreover, the supply of official credits is often limited to urban areas, yet local entrepreneurs often operate in rural areas and have a local bias in looking for credit. As a consequence, potentially promising diversification efforts in rural areas can be choked off by the lack of credit. Expanding the network of bank branches or creating savings associations at the farmer and/or exporter level seems therefore to be needed in many developing countries.

19. In undertaking structural adjustment to reduce fiscal deficits and government involvement in the economy through privatization and liberalization, a government may, inadvertently, make improving competitiveness and diversification more difficult. When combined with reform of commodity marketing boards and trading companies, expenditure cuts can impact negatively on the provision of such essential support services for commodity production and export as information, quality control, credit provision, marketing, and research and development.

20. Moreover, although economic reform designed to provide economic incentives is widely recognized as an indispensable element in the successful implementation of diversification programmes, only governments can establish and guarantee the reliable framework of regulations and basic infrastructure, in terms of both physical and human capital, which is an essential condition for dynamic private-sector activities. In addition, in areas where market failures prevail, the limitations of market forces are quickly reached, and policy makers have to choose between the failure of the market and the alleged inadequacy of the state to perform a number of key functions. Only when the conditions for private-sector responsiveness to economic incentives are present can the benefits of economic reform be reaped fully. The following paragraphs discuss those areas in which it appears that a government should play an active role. Whereas the

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[11] See UNCTAD: *The Least Developed Countries 1993-1994 Report*, (New York, 1994) pp. 54-58.

[12] One way of addressing this problem would be to deposit the commodities in warehouses managed according to international standards. This requires, *inter alia*, that the warehouses be legally independent and controlled by an independent and licensed trustee or warehouse company.

case for an active role of the state is widely acknowledged in some of these areas, it is controversial in others.

B. National policies designed to improve the capability of market participants to respond to economic incentives

21. Creation of an appropriate regulatory framework, including company and bankruptcy laws and investment codes, is one of the most important forms of government intervention. Developing countries often lack such a framework, in particular when liberalization measures are taken before a reliable legal framework conducive to private sector activities has been created. The conclusions of the workshop on "Commodity export policies and strategies in African countries in a process of structural adjustment",[13] for example, stress in this respect that the right of private individuals to acquire land and have a secure right of tenure is fundamental for farmers to have an incentive for taking good care of the land. Workshop participants also urged that licensing and registration procedures facilitate, rather than complicate, activities of the private sector, and that a code of business standards be implemented to permit sanctioning of unethical business behaviour so as to raise exporters' credibility in international markets.

22. It is generally recognized that the provision of basic infrastructure by the government is crucial for the successful development of competitiveness and diversification and that there is still broad scope for improvement in many developing countries in this area. Diversification efforts pose a particular challenge in this respect when physical infrastructure networks have been planned and built for traditional export commodities. For example, successful diversification in the export of fresh fruit and vegetables requires timely and reliable transportation of the produce to destination markets. However, when roads to international airports, cold storage facilities and air freight space are poorly developed or non-existent because such infrastructure is not needed for the export of traditional commodities, diversification efforts can be seriously constrained.

23. Experience in restructuring commodity marketing boards, which used to provide a wide array of export extension and marketing services, suggests that state entities have an important role to play in providing export extension services; this includes to provide market information and basic agricultural research, to develop and maintain quality standards, and to maintain and enhance the image and reliability of export structures, e.g., by providing appropriate and realistic legislation including an arbitration procedure for cases of dispute between clients and specific exporters. Experience also suggests that marketing itself, by contrast, appears to be best left to professionals of the private sector.[14] However, steps taken to improve the financial position of commodity marketing boards have led to reduced staffing of these entities and often meant a cessation of support services. Such services could, in principle, be provided by the private sector, but the appropriate legal framework and capabilities that would give impetus to local entrepreneurs to do so are often missing. The absence of appropriate quality standards and their enforcement caused by the abolition of the coffee marketing boards in Cameroon and Madagascar, for example, led to a significant drop in quality, and hence competitiveness, of coffee

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[13] See "Commodity export policies and strategies in African countries in a process of structural adjustment: cotton, tea and horticultural products", UNCTAD/COM/47, 1994: report of a workshop organized by UNCTAD with support from Australia, Israel, ITC and UNDP and held at Dar es Salaam, United Republic of Tanzania, in November 1993.

[14] Marketing issues are addressed in section C of this chapter.

exports from these countries.[15]

24. Problems of information or other imperfections in financial markets of developing countries suggest the presence of market failures preventing prices from transmitting the correct signals, or economic agents from responding to them. A recent study by the World Bank[16] concluded that directed credit and other forms of financial intervention may have helped Japan, the Republic of Korea and Taiwan, Province of China, to develop their industrial structure. The question therefore arises whether other developing countries should follow the example of the newly industrializing countries regarding government interference in financial markets. Although empirical evidence on this issue is scarce and more research is needed, it would appear that such market failure can justify government intervention in financial markets as in East Asia only when the financial sector already is fairly well developed, so as to ensure some degree of competition, and when enterprises as well as financial institutions are subject to some kind of bankruptcy law.

25. The importance of research and development for international competitiveness and the catalytic role of the government in this area for both the industrial and agricultural sectors scarcely needs restating. In agriculture, many developing countries have succeeded in developing high-yielding varieties and improved cultivation techniques. In Bangladesh, for example, research and development has contributed to achieving foodgrain self-sufficiency by widespread use of high-yielding rice varieties, improved farming and irrigation methods, as well as more efficient application of fertilizers.[17] In many developing countries in Africa, by contrast, cultivation methods differ little from those used decades ago. The apparent lack of research and development in African agriculture may be partly the result of the implicit taxation of agricultural activities caused by exchange rate misalignment and inappropriate producer-price policies. However, problems in finding financial resources also seem to have played a crucial role in this area. Not only have governments retrenched spending on research and development but also donors have not given priority to providing external finance so as to fill the gap caused by insufficient domestic funding. One solution to this problem could be to explore ways of co-financing research and development by the government and the private sector. The Farmers Horticultural Exports Association in Malawi, for example, obtained funding for this area from the ITC and UNDP mediated by the government and the Malawi Export Promotion Council.

26. Human capital formation is crucial for enhancing competitiveness, but fiscal restraint as part of economic reform has often been translated into a cut in education budgets, and precisely at a time when bilateral aid to education was not adequate to ensure maintenance of the already very low level of recurrent spending per pupil reached at the beginning of the 1980s. During the structural adjustment programmes in Senegal, for example, education spending fell from 33 per cent of GDP to 26-27 per cent, making it impossible to build new schools, or to alleviate the existing shortage of textbooks and the further worsening of teacher-pupil ratios.[18] The declines in the quantity of educational spending

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[15] For details see O. Matringe, "Analysis of coffee exports in Burundi, Cameroon, Cote d'Ivoire, Ethiopia, Kenya, Madagascar, Rwanda, Uganda and the United Republic of Tanzania", in: UNCTAD, "Government policies affecting coffee export marketing", Volume II, UNCTAD/COM/MISC.55/ADD.1 (1993).

[16] World Bank, *The East Asian Miracle* (Oxford, Oxford University Press, 1993).

[17] It should be noted, however, that many commentators have recently begun to urge a second look at "green revolution" policies in the light of the environmental damage caused by the intensive application of fertilizer common to these policies.

[18] See P. Noonan, "Continuing crisis in African education", in: *African Recovery*, vol. 7, No. 3/4 (1994) p. 23.

have hence directly translated into an erosion in the quality of schooling.

27. Practical learning may be as important as formal education for successful export diversification. Acquiring appropriate practice-oriented skills in packaging, marketing and other areas of pre- and post-harvest handling can contribute significantly to the improvement in quality of a country's exports, and hence to its competitiveness. However, many developing countries have invested little in skill upgrading, in part because several of the steps in skill upgrading have the characteristics of public goods, i.e., individual companies can appropriate the rewards only with difficulty. Overcoming the learning-to-learn barrier and the undertaking of contract research or other pre-commercial research activities are examples of this. In addition, the education market may fail to anticipate fully the skill needs of dynamic commodity (and other economic) sectors in time to provide an adequate base of human capital for realizing the full potential of these sectors. Further, companies may hesitate to invest in skill upgrading themselves fearing that they will not be able to retrieve the full benefits of their investment in case trained employees leave the company. These externality-caused market failures may deter socially desirable investment in human capital and warrant targeted government intervention in this area.[19]

28. To summarize, the above discussion suggests that creating an incentive system can be conducive to improving competitiveness and diversification only when factors bearing upon the responsiveness of economic agents to economic incentives are appropriate. An economic environment designed to facilitate diversification also must address legal, regulatory and structural impediments to the operation and expansion of the private sector. At the macroeconomic level, stable price signals and a sufficiently credible policy would seem to be important for evoking strong responses from risk-averse economic agents. Other factors include a legal framework that guarantees the predictable enforcement of contracts and property rights; the provision of basic infrastructure and supporting institutions, in particular in the areas of transportation, telecommunication and market information; development of a financial sector that allows exporters to have ready access to working capital and export finance; and a technology policy that assures human capital formation required for the assimilation of new production technologies.

C. Ways and means for a country to find market opportunities for its commodities

29. Economic reform strategies designed to improve a country's competitiveness often emphasize competitiveness in production and neglect the fact that finding market outlets and export marketing itself are crucial determinants of improving competitiveness and, in particular, export diversification. For the output of diversification efforts to be competitive on any market, there have to be persons who know and can use modern marketing techniques, have reliable sources of information and contacts, and are able to convey the needs of consumers to the production side.

30. The structure of commodity export marketing in developing countries has undergone considerable change.[20] For practically all commodities, there has been a significant increase in the number of both countries and persons active in commodity export marketing. In the case of base metals, the globalization

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[19] On this issue see also S. Lall, "Understanding technology development", in: *Development and Change*, Vol. 24 (1993) pp. 719-753.

[20] On this issue, see also J. Farooq and L. Rutten, "The challenge of marketing commodities from developing countries", in: B. Hartantyo, and H.P. Smit (eds.), *International Commodity Development Strategies*, (VU University Press, Amsterdam, 1993).

of activities of mining companies from developed countries and, more recently, the privatization of mining companies from developing countries are the main reasons for this development. The increased number of market participants has also contributed to both the change in price formation from a producer-price system to exchange-based reference prices and the increased use of modern marketing techniques in the metals area over the last few years. An exchange-based system of price formation leads by its very nature to higher short-term price volatility, compared to producer prices, and therefore demands better skilled personnel, ready and reliable access to information and more investment in maintaining a good and stable relationship with clients in order to be competitive in marketing. However, given that many mining as well as oil companies rely on large-scale production units, they can afford to maintain their own marketing department, with well-trained staff and direct access to world-wide information and communication networks, undertaking market studies, investing in the penetration of new markets, and having their own agents overseas.[21]

31. In the agricultural sector, the increase in the number of market participants has been mainly due to the liberalization of export marketing, as part of which centralized export agencies such as commodity marketing boards have been abolished in many developing countries. The relatively small size of the new market participants and their inexperience in international commodity marketing and marketing techniques has often hampered the maintenance of market shares for traditional export commodities, as well as the successful development of non-traditional exports. As a reaction to the atomization of export marketing of traditional commodities, for example in African cocoa-exporting countries, trade houses such as ED&F Man or Cargill have established their own network of buyers who purchase the commodity directly from the producer. However, the increase in new market participants consequent upon the demise of commodity marketing boards has meant that international trade houses do not know who would be a reliable trade partner. In such a situation, the natural response of the trade houses is to charge a risk premium to producers, with the result that farmers receive lower prices than otherwise. This marketing system is probably also less beneficial for exporting countries than possible alternatives, e.g. associations of exporters, as the producers and small local traders have very limited negotiating power. This is caused by their limited knowledge of modern commodity marketing techniques and by the fact that they have to cope with a generally poor domestic economic environment. They therefore compete on an unequal footing with representatives of the foreign trade houses who have access to all of the information, communication facilities, marketing expertise and financial resources of their parent company. In addition, this marketing system has proved to be costly for the trade houses because they need representatives in the country and may want to hold stocks larger than commercially and financially optimal because of their limited trust in the reliability of the small producers.

32. Cooperatives and associations of producers - grouping together several small and medium-sized producers for the provision of services such as transportation, information and marketing - have been a powerful instrument in several developing countries to raise the bargaining power of individual producers and create the image of being a reliable counterpart in trade. Experience of such cooperatives and associations shows that successful competition with agents from foreign trade houses depends very much on their size, financial situation and previous marketing experience. Those who have been successful usually had sufficient marketing experience to enable them to meet contractual obligations in terms of both timely delivery and quality. They also had a sufficiently solid financial position to be able to invest in advertising campaigns, product differentiation, own information services, overseas

[21] For example, all of the large oil-producing companies of Mexico, Saudi Arabia and Nigeria, as well as the main copper mining companies of Chile and Zambia, have offices in London.

representatives, training programmes, etc. Others, by contrast, have often suffered from inexperience in international marketing as well as from a lack of working capital and access to credit. This prevented them from giving prompt payment or offering pre-harvest credits.

33. Knowing how to make adequate use of modern marketing instruments has become indispensable for being a competitive participant in many international commodity markets. Commodity buyers and sellers increasingly use exchange-generated prices as reference prices for their physical trade, apart from using futures and options contracts for hedging. However, few commodity exporters from developing countries have actually made use of these instruments either directly, through hedging, or indirectly, using exchange-determined prices as reference prices in executable orders (often used in sugar trade) or price-to-be-fixed contracts (often used in coffee trade). One important reason for this has been that government policy makers often have a lack of understanding of, and information on, the functioning of commodity exchanges and risk management instruments, with the result that their policies have, in many cases inadvertently, hindered or prevented the use of such methods by private exporters. UNCTAD and the World Bank have addressed this problem in their technical assistance and training programmes, as well as issues concerning the strategic and company control structure aspects of risk management.[22]

34. However, not all problems developing countries and economies in transition have in using risk management instruments can be overcome by training efforts. Companies from developing countries and economies in transition are often not accepted as clients by intermediaries, such as international banks, which provide access to international risk management markets. Such intermediaries often consider the counterpart and sovereign risks involved in transactions with these companies too high. Counterpart risk, or the risk of company-specific defaults, can be the result of the debtor's bankruptcy or his misunderstanding of the objective of risk management instruments with the consequence that the company reneges on its contractual obligations. Sovereign risk refers to the possibility that a state-owned company defaults, or that a domestic private or a foreign company defaults because of a change in legislation by the government, e.g., its declaring the contract illegal or blocking the foreign exchange needed to fulfil the contract obligations.

35. Experience shows that several possibilities to overcome such access problems exist.[23] The prime consideration appears to be that the track record of a company in terms of meeting contractual obligations as well as its commercial strength, reputation and credit rating must be faultless. However, the risk assigned to a company by a risk-management intermediary can never be lower than the sovereign risk of the country in which the company is located because, in the final instance, any company must comply with government legislation in fulfilling contractual obligations. Accordingly, an important factor in meeting access problems is the existence of a legal framework which is both reliable and conducive to the use of risk management instruments. Second, a company can build a reputation of being a reliable counterpart by entering into transactions which at the beginning involve relatively little risk for the intermediary, and later entering into increasingly more complicated transactions with this same intermediary. Third, national foreign-currency regulations can be adjusted in such a way as to allow for offshore accounts of domestic companies; this lowers the risk that a company defaults because of its

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[22] These issues are documented in UNCTAD, "Contribution to the improvement of the functioning of commodity markets. Analysis of ways of improving the efficiency and use of existing mechanisms for the management of risks arising from commodity price fluctuations", TD/B/CN.1/10, 27 August 1993, and were discussed by the Standing Committee on Commodities at its second session.

[23] For a more detailed discussion of this issue see UNCTAD, *Counterpart and sovereign risk obstacles to improved access to risk management markets; issues involved, problems and possible solutions*", TD/B/CN.1/GE.1/3, July 1994.

inability to obtain the foreign exchange needed for the transaction. A fourth possibility is engaging in countertrade and barter arrangements, or pledging physical inventory as collateral. Finally, the intermediary of risk management instruments can contract for sovereign risk insurance to insure itself against non-delivery by a private company or a government agency and against confiscation and nationalization. However, in order to overcome counterpart and sovereign risk barriers to the enhanced use of risk management instruments, changes, often of a far-reaching nature, in legislation and economic policy in particular regarding access to foreign exchange may be required in many developing countries and economies in transition.

36. Having access to adequate trade-related information and the capacity to analyse this information in a way conducive to entering international trade is also an important factor in successfully developing trade opportunities for exported commodities. One way in which this can be done is via the "Trade Point" concept, initiated by UNCTAD "to open international trade to new participants - especially small- and medium-sized enterprises - by simplifying and harmonizing trade procedures worldwide and giving traders access to advanced technologies and information networks".[24] Trade Points have so far been created in 60 countries[25] with a view to establishing one-stop information centres in order to lower transaction costs of importing and exporting operations. Experience of many successful exporters of commodities suggests that regular and personal contacts have been of considerable help in establishing a relation of mutual trust with their clients as well as in obtaining sure market outlets. Such contacts may be initiated through activities of a Trade Point, in addition to family ties or contacts established through schooling abroad.

37. Using the services of an association for the promotion of exports of or imports from developing countries is a further way for developing countries to find market opportunities for their commodities. The UNCTAD/GATT International Trade Centre (ITC) advises governments of developing countries on their national trade promotion strategies, institutions and services. In particular, it provides information on new export opportunities and advises countries on how to adapt products for exports and to promote these goods on the international market. In addition, the ITC has made available trade manuals on physical trade for several commodities, such as cocoa, coffee, copper, horticultural products, sugar and vegetable oils and oilseeds. UNCTAD's TRAINFORTRADE programme has developed computerized courses on physical trade in cocoa, coffee and sugar, partly on the basis of these ITC manuals, and has also created courses on risk management for cocoa, coffee, cotton, palm oil and sugar. Other institutions also promote commodity trade. The COLEACP,[26] for example, promotes horticultural exports from ACP countries to countries of the European Union through the provision of marketing and general trade information services, technical and commercial training courses, technical assistance missions, trade and product promotion and the organization of an annual ACP/EU trade conference. Other bodies, such as the Dutch CBI (Centre for the Promotion of Imports from Developing Countries) for the market of the European Union and in particular the Netherlands, provide market information, intermediary services (e.g., databases on potential importers, organization of marketing missions or trade fairs) as

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[24] UNCTAD, "The Trade Point: concept and implementation", TD/B/WG.2/7/Add.1, 7 October 1993.

[25] For a list of countries in which Trade Points have been established, see UNCTAD, "Final report of the Ad Hoc Working Group on Trade Efficiency", TD/B/40(2)/L.6, 17 May 1994, annex II.

[26] The COLEACP is the Committee for Liaison between Europe and the African, Caribbean and Pacific countries signatory to the Lomé Conventions for the promotion of tropical and off-season horticultural exports. It was created in 1973 with the support of the Commission of the European Communities as an international, non-profit-making, private association.

well as training programmes, usually free of charge.[27]

38. Many developing countries have established national export promotion agencies, often under the administrative control of a ministry.[28] Experience with these agencies suggests that in order to be efficient they need to have the support of the local business community, be adequately funded, have an adequately qualified and paid staff, and have some independence from government. Export promotion agencies often lack support from the business community because they are too closely linked to the government and because they provide few follow-up services once the initial contact with trade partners is made via fairs or sales missions. This lack has proved to be a major obstacle for inexperienced exporters in trying to establish lasting trade relationships.

39. Despite this negative experience with national export promotion agencies, there is still a case for the establishment of agencies designed to provide market information and facilitate communication and cooperation between the private and public sectors, for diversification and taking advantage of market opportunities. A functional partnership between the government and the private sector has often been the key to successful export activities in developing countries in and outside East Asia (see box 2). The establishment of national diversification councils in African countries has been discussed in connection with the United Nations New Agenda for the Development of Africa in the 1990s. National diversification councils would address the presently existing gap in development assistance concerning the pre-investment phase activities (identification, preparation and appraisal) of diversification programmes. They would be designed to generate a stream of project proposals that fit into national diversification programmes and priorities, as well as be a focal point at the country level for the private sector and the government to work together to assess diversification opportunities in the light of local resource endowment, human capital, infrastructure and technology. Such a council would, by contrast, not have the power to decide on or execute specific pre-investment activities.

40. Exploiting environmental advantages offers considerable potential market opportunities for developing countries. Such opportunities can be expected to grow with increased environmental consciousness on the part of consumers, suitable legislative frameworks in importing countries and convincing evidence of the environmental advantages of exported commodities. In many instances, one of the crucial issues in this area is persuading consumers to pay a higher price for a commodity produced on an environment-friendly basis compared to the price for an established product. Among the best known examples in this area is coffee sold in several European countries under the brand name "Max Havelaar", or the cooperation between importers of cotton textiles and Turkish exporters. Other crucial issues are to improve the technical characteristics of some commodities and to adapt industrial technologies to facilitate substitution by environment-friendly products; examples of this include improving the quality of natural fibres for increased industrial use and changing some aspects of automobile engines to allow for the use of sugar-based fuel.[29]

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[27] For an annotated list of import promotion agencies, see UNCTAD, "The improvement of information flows to aid investment decisions", TD/B/C.1/AC/11, 23 August 1990, p. 22.

[28] Parts of this paragraph draw on D. Keesing and A. Singer, "Why official export promotion fails", in: *Finance and Development*, vol. 29 (1) (1992) pp. 52-53.

[29] For a more detailed discussion of this issue see UNCTAD, "Identification of means by which the competitiveness of natural products with environmental advantages could be improved", TD/B/CN.1/25 (1994).

Box 2

Deliberation councils and other functional partnerships

Successful diversification and export promotion have frequently been spurred by institutional partnerships linking the government and the private sector. Examples are provided by the role deliberation councils have played in Japan, the Republic of Korea, Malaysia and Singapore. Within these councils "private sector groups are invited to help shape and implement the government policies relevant to their interests. In contrast to lobbying where rules are murky and groups seek secret advantages over one another, the deliberation councils are intended to make allocation rules clear to all participants." (see *"The East Asian Miracle"*, op. cit., p.14.) It can be said that from "an economic standpoint, ... [deliberation] councils facilitate information transmission. They enable the bureaucracy to gather information about world markets, technology trends, and the impact of regulations domestically and abroad, synthesize the information into an action plan, and communicate the plan back to the private sector. Self-interested behavior is more or less constrained by the repeated nature of the collaboration. This in part helps establish credibility - private sector participants believe cheating and reneging are less likely." (Ibid, p. 187.) These councils also serve as a medium of exchange of points of views regarding changing conditions in world trade, finance and marketing conditions; developments within the domestic economy; the channels through which policy instruments affect economic conditions; opportunities created by technological progress; and about the interaction between government measures and other policy variables.

Other examples include the Kenyan tea and horticultural sectors, where the government has provided valuable supervisory and regulatory support, in particular in the areas of quality control and research and development, while not interfering in export marketing. The privately managed Fresh Produce Exporters Association of Kenya has collaborated closely with the government on all issues concerning the horticultural sector and taken over several functions of the state-owned Horticultural Crops Development Authority, including the provision of extension services, training, market information and other services to its members. In general, the roles of the private sector and the government have been well defined with the private sector controlling production and marketing and the government providing institutional support. In the Israeli cotton sector, research and development projects and quality control are financed jointly by the government and cotton growers, while export marketing is done through the Cotton Production and Marketing Board which was created and is owned by the growers. Another form of government support to private-sector activities that has been employed by developing countries regards the adjustment of investment codes so as to attract producers and exporters who were successful in other countries in the respective commodity sector. In the United Republic of Tanzania, for example, the bulk of exporters in the horticultural sector are those who had previous experience in Europe (Dutch investors exporting flowers) or Kenya (Kenyans or Tanzanians with family ties to Kenya exporting fruit and vegetables). Chile succeeded in boosting its exports of fruit by taking advantage of the marketing knowledge and long-established trade links of a transnational corporation.

41. Commodity exporters from developing countries often face trade barriers of various kinds which can impair their ability to penetrate new markets. Several countries have, however, been able to counter such barriers. Flower producers in the United States, for example, filed anti-dumping and compensatory rights suits against Colombian flower exporters to obtain an additional tax on Colombian flowers. The legal costs for Colombian exporters involved in such lawsuits were paid by the Government. This Government support succeeded in limiting the adverse effects on the competitiveness of Colombian flower exporters: adequate defence avoided an anti-dumping margin for a long time; moreover, lobbying activities succeeded in halving the level of the margin once it was put in place. Trade barriers have also been established by importing countries on the grounds that the exporting country pursues environmental or health policies different

from its own. The United States' Marine Mammal Protection Act 1972, for example, prohibits imports of any commercial fish or fish products harvested by a method that results in the incidental killing of or serious injury to marine mammals in excess of United States standards. This is the case, for example, for yellowfin tuna harvested with purse seine nets in the eastern tropical Pacific, a method which has resulted in the incidental killing and injuring of many dolphins. A recent GATT dispute settlement panel, with the EEC and the Netherlands as co-complainants against the United States, however, found that it was not justified to impose a trade embargo in pursuit of environmental objectives in order to secure changes in policies which other countries pursued within their own jurisdiction.[30]

42. To summarize, evidence from developing countries which have made substantial progress in terms of export diversification and taking advantage of market opportunities suggests that a focus on competitiveness in the sense of "getting the prices right" is too narrow. To the extent that measures designed to build competitiveness are associated with reduced public and private investment and reduced basic extension services, those measures can actually be counterproductive. Good knowledge of marketing practices has become imperative for a country to find market opportunities for its commodities as well as to ensure that identified export markets can be penetrated and maintained, and only those with the means to invest in manpower and information systems are likely to be able to build up such knowledge. Developing a functional partnership and division of responsibility between the government and the private sector seems to be crucial for both economic development and export diversification. In such a partnership, governments may find it necessary to restrict their role to that of providing an enabling environment, while the actual implementation of production and marketing activities could be in the hands of the private sector.

Chapter III

INTERNATIONAL POLICIES AFFECTING MARKET OPPORTUNITIES FOR COMMODITIES AND OPPORTUNITIES FOR DIVERSIFICATION

A. Ways and means of increasing the market opportunities for commodities in the medium term

1. Market access

43. It is almost self-evident that market opportunities for exported commodites will improve when market access barriers are lowered. The outcome of the Uruguay Round in this regard is to be analysed in the newly established Ad Hoc Working Group on Trading Opportunities in the New International Trading Context. However, the benefits of barrier reductions are almost always quickly appropriated by those with existing production capacities as they are in a position to respond to new opportunities. The question then arises as to whether the Uruguay Round progress on barrier reduction will bring much real benefit to highly commodity-dependent developing countries which are in need of diversification. Therefore, how best to help these countries take advantage of market access liberalization is not clear and requires further analysis.

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[30] For details, see GATT, "United States - Restrictions on imports of tuna. Report of the Panel", DS29/R, 16 June 1994.

2. Improving information on demand and market requirements

44. For commodities, as for any good, it is primarily the consumer who dictates the quantity and quality of the item being bought. It is thus a necessary condition for a successful producer or exporter of commodities to know how to find and take advantage of information on market requirements, and he can be assisted in this effort by various national actions as outlined in chapter II. The international community has addressed the issue of improving information flows on commodities frequently. Several international agencies such as FAO, UNCTAD,[31] ITC and the World Bank collect and provide commodity-related information in various formats and at varying time intervals. While these actions help in providing data on supply, demand, prices, and trends, nevertheless the main source of up-to-date information relevant for marketing commodities remains, and will likely remain, the private business community.

45. The international community can help to stimulate demand for commodities by facilitating access by producers and exporters to relevant usable information. The ways of so doing include training on how to find, use and assess information and information sources, such as is provided by ITC in many of its country projects; assistance in the setting-up of exporter/importer groups such as COLEACP; and using import facilitation agencies as conduits for information. Useful also is the provision of funds for collecting and disseminating data on products where the commercially provided information is scarce and/or very expensive.[32] Rational resource allocation requires, of course, that users pay for the information they need for their commercial business; however, equity considerations suggest alleviation of the cost burden for developing country producers and exporters, for example, through cost-sharing among users or with donors.

3. Generic promotion of commodities

46. Generic promotion appears to succeed when demand is growing relatively well. Successful campaigns have included the promotion of wool through the woolmark, similar labelling for cotton and rubber, and health-related campaigns for certain foods such as unsaturated vegetable oils. When markets are close to saturation, however, generic campaigns flounder on competition among producers, and product differentiation for the same commodity becomes important. This happened, for example, with tea promotion through the International Tea Association in the mid-1980s.

47. Recent efforts at generic promotion have attempted either to promote demand for traditional commodities in specific markets which have low consumption per capita as compared to other markets[33] or to promote traditional commodities which appear to have environmental advantages in traditional markets.[34] The

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[31] This issue was discussed in detail by the Working Party on Diversification, Processing, Marketing and Distribution of the Committee on Commodities in November 1990 on the basis of the secretariat report TD/B/C.1/AC/11 entitled "Information flows to aid investment decisions".

[32] The Market News Service of ITC is particularly noteworthy for its efforts to provide frequent information on specific commodities for which public sources are rare.

[33] This is, for example, the rationale behind the project to promote cocoa consumption in Japan being financed jointly by the Second Account of the Common Fund and the Chocolate and Cocoa Association of Japan.

[34] Examples include sisal and jute market promotion projects by the ITC and programmes in some countries to promote organic coffee or other foods grown under environment-friendly conditions.

latter type of campaign attempts to create new demand or niche markets, whilst the former type attempts to change consumer preferences. Generic promotion could be envisaged as an integral part of efforts to find new end-uses for commodities, in order to make consumers aware of the existence and qualities of the new products developed. In this regard, a generic promotion component could be built into any multi-country project concerned with new end-uses, such as those sponsored by the Second Account of the Common Fund.

48. Demand for commodities exported by developing countries can be positively affected by the support provided by import promotion agencies of various developed countries. These promotion agencies are not geared only to commodity exports and naturally respond to demand for information on product groups of interest to their clients, both importers and exporters. As a result it is usually the more organized and enterprising developing countries which take advantage of their facilities.

4. Promotion of new end-uses of commodities

49. Experience suggests that the most effective way of improving the demand for a commodity is to find new uses for it. Examples of this abound, ranging from the use of sugar as a fuel and as a fertilizer to the use of cocoa in cosmetics and to the development of materials made from new blends of metals or of furniture from rubber trees. The development of new end-uses is a research-intensive activity, funding of which is usually done by specific entities in the private sector, which then draw commercial advantage from the results, using patents, licences and other devices. Some research is, however, undertaken in the public domain with the results available to all producers; for example, this is how the "green revolution" spread and new varieties of rice were developed. In certain cases, commodity-specific research institutes exist under the aegis of several governments, such as those for rubber and tea; or university departments are funded, as for palm oil in Malaysia. The international community has traditionally supported research activity but funds have become relatively scarce with reductions in aid budgets.

50. Research on new end-uses has to be supplemented by trial production and model factories, followed by trial sales and use by consumers. This is an area where the Second Account of the Common Fund is making a modest contribution through projects on use of sugar and cocoa by-products, rubberized coir and coir geo-textiles, rubber packaging materials and zinc die casting.[35] While the results of these projects will be available to other producers, there is also a need to promote the new products with consumers. It would therefore seem most logical for all new end-use projects to include a promotion element to be activated once the production of the new product is shown to be feasible. Moreover, it should be borne in mind that although some new uses may satisfy unmet consumer needs and so increase aggregate demand, others may be competing with the use of alternative commodities and hence contribute to a reorientation of demand rather than its increase.[36]

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[35] See Common Fund for Commodities, *Annual Report of the Managing Director on the Activities of the Fund*, (Amsterdam, 1993).

[36] This is, for example, what occurred with the use of vegetable oils rather than cocoa butter in chocolate, and with the use of aluminium rather than heavier metals in transport vehicles.

B. Support for diversification

51. The implementation of diversification activities is primarily a national responsibility, with the national policy framework within which these activities take place being of crucial importance, as discussed in chapter II. However, there are certain policies at the international level, including policies on market access which have a decisive influence. The international community has also committed itself to providing support to national diversification programmes, particularly for countries which remain excessively dependent on a limited number of commodities for their export earnings. This support can be classified into four types: support relating to policy issues, including support for exchanges of experience on national policies and actions; the provision of information relevant to pre-investment activities; technical assistance for training, for assessing feasibility, for making technology choices and for market penetration; and the provision of funds for investment activities per se.

52. Exchange of experience is very useful for developing country governments in deciding on elements of national policy which are most conducive to their objectives, including diversification. The international community has promoted such exchanges via intergovernmental meetings including the General Assembly[37] and UNCTAD,[38] but these discussions have had a tendency to remain at a fairly general level without much direct interest to the governments of the concerned countries.

53. It appears therefore that the most practical way of using material on issue-based and country case studies would appear to be exchange-of-experience seminars at the subregional level, involving two or three commodities and a limited number of countries, with resource persons from countries which had successful diversification experience in one or more of the selected commodities, and participants from both government and the commodity sectors themselves. Such seminars allow for both a very concrete exchange of actual policies tried and their results, and also a face-to-face discussion between government policy makers and representatives of their commodity sectors. This type of seminar was conducted last year in East Africa;[39] the ECA is planning a similar seminar in Cameroon in the second half of 1994. Organization of such workshops would be one of the functions of the proposed diversification fund for Africa's commodities in its work with national diversification councils.

54. Information relevant to pre-investment activities includes both information on possible external markets and a clear assessment of national opportunities.[40] One problem in this area is whether the interested persons at a national level are aware of the sources of information and can assess their credibility;

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[37] See, for example, the discussion under the review of UNPAAERD (United Nations Programme of Action for African Economic Recovery and Development) in the report, "Implementation of diversification in the commodity sector in Africa at the national, subregional and regional levels with the support of the international community", A/46/324/Add.1 (1991) and subsequent discussions.

[38] See the discussions of the Working Party on Diversification, Processing, Marketing and Distribution of the Committee on Commodities, 1987-1990 and the discussions of the second session of the Standing Committee on Commodities, February 1994.

[39] For a report on this seminar, see *"Commodity export policies and strategies in African countries in a process of structural adjustment: cotton, tea and horticultural products", op. cit.*

[40] Information relevant to such assessment includes up-to-date geophysical surveys, soil characteristics, and other national information on seasonality or regularity of production, labour force skills of various types, and existing plants for processing and their experience.

assistance in assuring the flow of information to countries is therefore crucial. Assistance is also required in structuring information and assessments into a coherent whole, so that potential investors have a clear picture and good prefeasibility studies can be developed. This is the area of action proposed for the African diversification fund,[41] as it is in Africa that information for pre-investment activities is the weakest. Although the General Assembly, in adopting resolution 48/214 in December 1993, called for intensive consultations on the issue of diversification of African economies, specifically the establishment of a diversification fund for Africa's commodities, at the time of writing (June 1994) consultations held had been inconclusive; further consultations are scheduled for September and results should be known by the time of the Standing Committee meeting.

55. A related issue in this area is concern about creating oversupply by promoting diversification into the same products in several countries at once. While decisions on the viability of specific projects are the responsibility of the investors involved, information on investment plans of others in the same commodity would appear to be a vital element in their decision-making process. The international community can help in this process by undertaking regular periodic reviews on production, consumption and investment plans in commodity-specific bodies, such as is done for iron ore and is foreseen in the International Cocoa Agreement, 1993, and then make information on their conclusions widely available. Also, financing institutions such as the World Bank Group, the Centre for Development of Industry of the Lome Convention or the Commonwealth Development Corporation can alert potential investors to possible overlaps.

56. Much technical cooperation is available, but one of the problems facing potential beneficiaries is that of not knowing whom to approach for what. Also, the conditions attached to the provision of assistance are sometimes rather onerous or tied to the use of specific inputs. Donors are often unsure of how to evaluate the relative usefulness of various forms and types of assistance, as witnessed by the repeated evaluations and changes in focus and priorities by financing agencies. It would appear that the international community could do more to coordinate the demands and offers of assistance in the commodity area, at the country level, among organizations providing assistance and through better focused reviews.

57. A review of the area of investment finance for diversification projects undertaken in UNCTAD in 1990 showed not only that the amount of international finance actually made available for this area was small but also that this finance tended to be concentrated on the countries which were already rather diversified.[42] This conclusion is still valid today, as these countries have a good track record, know how to present good project profiles and are thus comparatively attractive to potential investors. There have been efforts by international financing agencies, often in cooperation with potential foreign private investors and international banks, to find ways of structuring financial arrangements to increase the feasibility of investments in the commodity area in developing countries. However those that have been able to profit from such arrangements to date are a limited number of mineral or fuel producers and the possibilities for expanding the number and types of structured arrangements do not seem very large for the near future.[43]

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[41] See United Nations "Need for and feasibility of the establishment of a diversification fund for Africa's commodities", A/48/335 (New York, 1993).

[42] See "Adequate financial resources for diversification: financial resources for diversification projects and programmes", TD/B/C.1/AC/12 (1990).

[43] For a discussion of the issues involved in structuring investment loans in the commodities area, see *"Counterpart and sovereign risk obstacles to improved access to risk management markets; issues involved, problems and possible solutions"* TD/B/CN.1/GE.1/3 (1994).

58. Much of the finance for smaller commodity diversification projects continues to be provided by local entrepreneurs. However, commodity producers and traders have not been able to access domestic capital very easily in many countries. Existing assistance in helping these entrepreneurs get access to overseas capital or find foreign partners thus needs to be accompanied by assistance for improvements in their local banking sector.

C. Conclusions

59. Support for diversification from the international community will for the coming decade be of crucial importance to low-income, highly commodity-dependent developing countries. National policies alone are unlikely to be able to cope with the entire weight of dependency on increasingly competitive international commodity markets. A coordinated and sufficient response particularly focused on these countries in relation to the issues identified above would certainly contribute to helping them develop a viable response to this situation.

60. The analysis in this report indicates that there is a need:

1. to make improvements in the supply of information for assessing market opportunities and for pre-investment activities and, particularly, in information analysis and assessment;

2. to increase and facilitate access to investment finance, both local and foreign;

3. to increase competitiveness through improving knowledge of marketing systems and practices; and

4. to develop concerted technical cooperation activities in the commodities area which are more sharply focused on countries excessively dependent on a limited number of commodities.

Concretely, the Standing Committee on Commodities could encourage progress in these directions, particularly by initiating or recommending actions through its members' technical cooperation programmes. It could also encourage a more direct and useful exchange of experience on related national policy questions through sponsoring a series of regional or subregional workshops.